

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLANT**

76-4235

IN UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

DOCKET NO. 76-4235

JOSE E. MORE AND ADELA T. MORE,
Appellants,
- against -
COMMISSIONER OF INTERNAL REVENUE,
Appellee.

ON APPEAL FROM THE UNITED STATES
TAX COURT

BRIEF FOR APPELLANTS

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Legislative History:

H. Rept. No. 749, 88th Cong.,
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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- - - - - X
JOSE E. MORE AND ADELA T. MORE, :
Appellants, :
v. : Docket No. 76-4235
COMMISSIONER OF INTERNAL REVENUE, :
Appellee, :
- - - - - X

BRIEF FOR APPELLANTS

PRELIMINARY STATEMENT

The finding of fact and opinion of the Tax Court are by a regular opinion, 66 T.C. No. 4. The opinion is by the Trial Judge, Honorable Theodore Tannenwald, Jr.

The case involves a deficiency in Federal income tax determined against Appellants Jose E. and Adela T. More, for the taxable year 1964 in the amount of \$93,676.87. The deficiency is based in part on a determination by the Commissioner of Internal Revenue that Appellants were not eligible to utilize income averaging under the provisions of §§ 1301-1305* to determine their taxes for the year in question because Appellant Jose E. More was not a resident

*All section references, unless otherwise indicated, are to the Internal Revenue Code of 1954, as amended (the "Code").

of the United States during all four "base period" years, as defined in § 1302(c)(2).

The Court below determined that Mr. More was a nonresident alien for part of 1960 (Tr. 118, R. 15*; Op. 5, R. 28), one of the base period years, and held that Appellants were not eligible to elect income averaging for the taxable year 1964. (Op. 13, R. 36.)

QUESTION PRESENTED

Whether Appellants are eligible for income averaging for the taxable year 1964 under §§ 1301-1305.

STATEMENT OF FACTS

Appellants, husband and wife, resided in New York, New York, at the time of filing their petitions to the Tax Court. They filed Federal income tax returns with the District Director of Internal Revenue, New York, New York for the taxable years 1960 through 1964.

At the time Fidel Castro acceded to power on January 1, 1959, Appellants were residents of Cuba, where Mr. More was a sugar and stockbroker. When Mr. More realized that he could not continue his business in Cuba under the new government he decided to relocate his family

*"R." references are to the separately bound record appendix.

in the United States. All of Appellants' property remaining in Cuba was expropriated by the Cuban government, under circumstances which Appellee concedes constituted a deductible loss. (Op. 3, R. 26; Stip. ¶ 4, 8, R. 8, 9.)

Mr. More held a Cuban passport issued on April 24, 1958 which contained a nonimmigrant visa issued by the United States Embassy in Havana on October 8, 1958, "valid for unlimited applications for admission into the United States if presented before October 7, 1962." He was admitted to the United States and readmitted to Cuba at various times during the period from December 6, 1958 through March 15, 1960. (Op. 3, R. 26; Stip. ¶¶ 9-12, R. 9-11.)

Mr. More was not in Cuba after March 15, 1960. He applied for permanent residence status in the United States at Montreal, Canada on June 20, 1961, and became a United States citizen on July 18, 1966. (Op. 4, R. 27; Stip. ¶ 18, R. 13.)

Based on the above and other facts recited in the opinion, the Court below made an ultimate finding of fact that Mr. More was a nonresident alien for at least part of the calendar year 1960. (Op. 5, R. 28.)

After application of the net operating loss and net operating loss carryforward deductions arising from their Cuban expropriation losses, Appellants had no

taxable income for the years 1960 through 1963. With respect to the taxable year 1964, Appellants had taxable income in the amount of \$204,747.19. (Op. 6, R. 29; Stip. ¶ 4, R. 8.)

ARGUMENT

Notwithstanding the finding made by the Court below that Mr. More was a nonresident alien for part of the calendar year 1960, Appellants contend that they are eligible for income averaging with respect to their taxable year 1964 under the pertinent provisions of the Code.

Section 1301 indicates that an "eligible individual" is entitled to the benefits of income averaging. The term "eligible individual" is defined by § 1303(a) as any individual who is a citizen or resident of the United States throughout the computation year, a term which is defined in § 1302(c). However, § 1303(b) excludes from that definition individuals who are nonresident aliens at any time during either the computation year or the base period. The term "base period" is defined in § 1302(c) as "the 4 taxable years immediately preceding the computation year" (emphasis supplied).

Since it is clear that Mr. More was a resident of the United States during the calendar year 1964, which is the computation year, and during the calendar years

1961, 1962, and 1963, which are three of the four years which constitute the base period, the sole issue is whether Mr. More was a United States resident for the "taxable year" 1960, his first base period year.

The provisions relating to income averaging do not define what constitutes a taxable year for base period purposes. However, Congress anticipated that a taxpayer might have a taxable year of less than twelve months and still qualify for income averaging by providing in § 1304(f)* that in the case of any computation year or any base period year which is a "short taxable year", the income averaging provisions are to "be applied in the manner provided in regulations prescribed by the Secretary."

Reg. § 1.1304-6, entitled "Short taxable years" is the provision under the income averaging regulations that amplifies the Congressional mandate contained in § 1304(f) to promulgate regulations in this area.** Reg. § 1.1304-6, in defining the phrase "short taxable years" incorporates the provisions of § 443(a)(1) and (2) which are an integral part of Part I, Subchapter E, (§§ 441-443) of the Code, relating to the period for computation of taxable

*§ 1304(g) was redesignated § 1304(f) by Public Law 91-172, the Revenue Act of 1969.

**Reg. 1.1304-6 was promulgated in proposed form in the Federal Register on April 9, 1965 and was promulgated in essentially the same final form on June 1, 1966, T.D. 6885. Income averaging, §§ 1301-1305, first became effective in 1964.

income for purposes of filing a tax return. Reg. § 1.1304-6* permits a short taxable year to be considered as a computation or base period year in only two situations, viz., where there has been a change in an annual accounting period and where the taxpayer was not in existence for the entire taxable year. This substantially tracks the provisions of § 443(a)(1) and (2).

Thus Reg. § 1.1304-6, through such incorporation by reference, equates the concept of a "short taxable year"

*§ 1.1304-6 provides, in relevant part, as follows:

SHORT TAXABLE YEARS.--(a) Change of annual accounting period. (1) If an individual is required under section 443(a)(1) and the regulations thereunder to make a return for a short period, such short period may be treated as a computation year or a base period year. For purposes of this section, a "short period" means any period of less than 12 months for which a return was required to be made under section 443(a)

.

(b) Taxpayer not in existence for entire taxable year. If an individual is required under section 443(a)(2) and the regulations thereunder to make a return for a short period, such short period may be treated as a computation year or a base period year. The amount of such individual's taxable income (if such short period is a computation year) or his base period income (if such short period is a base period year) is computed as if such short period were a taxable year of 12 months ending on the last day of the short period.

(c) Termination of taxable year for jeopardy. An individual who is required under section 443(a)(3) and the regulations thereunder to make a return for a period of less than 12 months shall not take such short period into account as a computation year or a base period year.

for purposes of income averaging with the filing requirements for Federal income tax returns covering any "short period" of less than 12 months within the meaning of § 443(a)(1) and (2). As will be seen, this overlay of the Appellee's tax return filing requirements upon eligibility requirements for purposes of income averaging is ill-conceived and produces a result not intended by Congress.

Nevertheless, it is Appellants' position in this case that they meet the requirements of the regulations. Alternatively, Appellants contend that the income averaging regulations incorporating § 443 are inapplicable, and that other Code provisions and regulations permit Appellants to elect the benefits of income averaging for 1964.

POINT I

APPELLANTS SATISFY THE
REQUIREMENTS OF REG.
§ 1.1304-6 FOR PURPOSES
OF INCOME AVERAGING

Reg. § 1.1304-6(b) states in pertinent part that "if an individual is required under section 443(a)(2) and the regulations thereunder to make a return for a short period [less than 12 months], such short period may be treated as . . . a base period year."

Section 443(a)(2) states in substance that a tax return for a period of less than 12 months, referred to as a "short period", must be made "[w]hen the taxpayer is in existence during only part of what would otherwise be his taxable year." Appellants believe that the meaning of the term "taxpayer", as used in § 443(a)(2), is dispositive of the issue presented by this case. The term "taxpayer" is defined by § 7701(a)(14):

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof -

.

(14) TAXPAYER. - The term "taxpayer" means any person subject to any internal revenue tax. (Emphasis supplied.)

Mr. More was a United States resident at least from and after March 15, 1960. (Op. 4, R. 27.) For an indeterminate period before that date in 1960, the Court below held that he was a nonresident of the United States. (Op. 5, R. 28.)

The question presented is whether Mr. More, who received no income from sources within the United States during the period in 1960 in which the Court below found him to be a nonresident of the United States (Op. 7-8, R. 30-31), was a "taxpayer in existence" within the meaning of § 443(a)(2). Manifestly, since Mr. More was not "subject

to any interval revenue tax" until he became a United States resident, he could not be a "taxpayer" during this time and, consequently, he could not be a "taxpayer in existence" during the same period. If he was not a "taxpayer in existence" during the portion of 1960 when he was a nonresident alien, it is clear that under § 443(a)(2) he was required to file a tax return for the "short period" in 1960 when he was a resident (and a taxpayer in existence). Thus, Mr. More meets the requirements of Reg. § 1.1304-6(b) for establishing a base period year of less than 12 months.*

The phrase "subject to any internal revenue tax" in § 7701(a)(14), relating to definition of the term "taxpayer", is conceivably applicable to all individuals, whether or not they are nonresident aliens with respect to the United States, where such individuals might at some time receive taxable income from the United States. Such an interpretation of the statutory language, which can be inferred from Appellee's position in

*It should be noted that Appellants' position poses no threat to the revenue by abrogating the effectiveness of the Appellee's regulations with respect to "dual-status" years of resident alien individuals departing the United States. This is a point which concerned the Court below. (Op. 11, f.9, R. 34.) While an individual nonresident alien is normally not a taxpayer subject to tax by the United States prior to entering this country, he is usually a "taxpayer" subject to tax by the United States prior to his departure and, thus, cannot escape any United States tax liability by relying on Appellants' position herein.

this case, is too broad where nonresident aliens are concerned. Case law supports this conclusion.

In Aguilar v. United States, 501 F.2d 127 (5th Cir. 1974), the Court faced the question whether a nonresident alien individual had a right to show that the seizure of his property pursuant to a jeopardy assessment was arbitrary and capricious and thus obtain injunctive relief in spite of the provisions of § 7421. In holding in favor of the nonresident alien individual, the Court stated:

Appellant is a citizen and a resident of Mexico. He owns a trucking business which he operates exclusively in the Republic of Mexico. He did all of his business in Mexico and was not a taxpayer [citing § 7701(a)(14)] within the meaning of the Code, had no duty to file a return and had no income subject to taxation by the United States. Id. at 129 (emphasis supplied; footnotes omitted).

In Robert L. Bunnell, 50 T.C. 837 (1968), several individuals owned a corporation and made an election under Subchapter S of the Code, the effect of which was to treat the corporation as a non-taxable conduit (much in the same manner as a partnership is treated under the Code) with the shareholders deemed the taxpayers. The Government issued statutory notices of deficiency against the individual shareholders. Portions of the deficiencies determined by the Government were based on adjustments to the income

of the corporation. The individual shareholders argued that the statutory notices of deficiency were invalid because such notices were not mailed to the "taxpayer", i.e., the corporation. (Deficiency notices were mailed only to the shareholders of the corporation.) The individual shareholders took the position that by filing the information return required of a Subchapter S corporation by § 6037 the corporation was expressly made subject to the statute of limitations on assessment of deficiencies. From this they argued that the Subchapter S corporation must be the "taxpayer" and, since a notice of deficiency was not mailed to the corporation in a timely fashion, the statute of limitations had expired. As a consequence, they contended, the notices of deficiency mailed to them were invalid.

The Government in Runnel contended that since § 1372(b)(1) provides that an electing Subchapter S corporation "shall not be subject to the taxes imposed by this chapter" (emphasis supplied), that the corporation was not a "taxpayer" within the meaning of the relevant Code section.

The Tax Court, referring to the definition of taxpayer in § 7701(a)(14), found that a technical application of that provision might require that the Subchapter S corporation be termed a "taxpayer" within the meaning of § 7701(a)(14) because the Subchapter S election "did not

extend its freedom from tax to every 'internal revenue tax'; it still remained liable for other taxes imposed by the Code--for example, social security taxes payable with respect to its employees" Id. at 841.

In language that could have been written for the instant case, the Tax Court in Bunnel stated that "such a construction has only the merit of literalistic consistency." Id. at 841. Finding that § 7701(a)(14) should not be interpreted in a manner which would be "'manifestly incompatible with the intent of' other sections of the Code," id. at 841, the Tax Court held that the Subchapter S corporation was not the "taxpayer" and that the deficiency notices fully satisfied the statutory requirements. The Court also found that "[a]ny other conclusion would require an 'archaic spirit' which we are not prepared to accept as our inspiration for decision." Id. at 842.

Thus, the Fifth Circuit in Aguilar clearly held that a nonresident alien individual with no United States source income was not a taxpayer within the meaning of § 7701(a)(14), and the Tax Court, in a more sophisticated approach, held in Bunnel that a domestic corporation not subject to income tax was not a taxpayer within the meaning

of the same provision, even though it might be "subject to" other internal revenue taxes.*

While the Aguilar case is precisely on point for Appellants, the Bunnel case implements the statute more meaningfully. In Bunnel, as in the instant case, the party involved was not subject to an income tax liability during the pertinent period. In Bunnel, the Court's interpretation of the term "taxpayer" made other Code provisions applicable. (In Bunnel, the notice of deficiency provisions of § 6212 were made operative. In the instant case, the provisions of § 443(a)(2) requiring Mr. More to file a return for the "short period", became effective.) Most significantly, in Bunnel the Government advocated essentially the same interpretation of the term "taxpayer", as do Appellants in the instant case.**

*Other Code sections, requiring an election to be made by a "taxpayer", have been made effective with respect to a person making the required election, who was not a "taxpayer" within the meaning of § 7701(a)(14). Demirjian v. Commissioner, 457 F.2d. 1 (3d. Cir. 1972), aff'g 54 T.C. 1961 (1970); James T. Tracey T.C. Memo 1973-28.

**The argument set forth in Point I above regrettably was not made to the Court below, where Appellants indicated their belief that this case did not involve a taxpayer not in existence for the entire taxable year and that Reg. § 1.1304-6, as a consequence, appeared to be inapplicable. Further research in connection with this appeal indicates this position to be incorrect as a matter of law. While Appellants recognize that it was unfair to the Court below not to have raised the arguments there, Appellants now believe that Point I may be dispositive of the question before this Court. There is no prejudice to Appellee in raising the argument at this time, since it involves solely an issue of law and not an issue of fact, which can be as adequately briefed and argued to this Court as it could have been to the Court below.

POINT II

ASSUMING, ALTERNATIVELY, THAT
APPELLANT JOSE E. MORE WAS A
TAXPAYER IN EXISTENCE DURING
ALL OF 1960, APPELLEE'S
REGULATIONS UNDER § 1.1304-6
ARE INAPPLICABLE AND OTHER
PROVISIONS UNDER THE CODE
QUALIFY APPELLANTS FOR INCOME
AVERAGING

Assuming, alternatively, that Appellant Jose E. More was a "taxpayer in existence" during all of 1960, Appellee's regulations under § 1.1304-6 cannot be viewed as the exclusive basis for determining the meaning of the phrase "short taxable year" as it is used in § 1304(f) of the income averaging provisions.* Appellants assert that other provisions of the Code supply an equally rational interpretation of that phrase, and one that supports their claim to qualify for income averaging.

It should be noted, first, that there is no indication in Reg. § 1.1304-6 that its provisions, incorporating § 443(a)(1) and (2), are to be exclusively relied upon to define the term "short taxable year" for purposes of income averaging. In fact, there are many discrepancies

*This issue only arises if a nonresident alien individual electing income averaging changes his status to that of a resident of the United States in the earliest year of the four base period years. A taxable year of less than 12 months during which a taxpayer was a nonresident alien, which occurred at any other time during the four base period years preceding the computation year, would appear to eliminate any question of eligibility for income averaging.

between the income averaging provisions and those of § 443 which suggest that they are incompatible. For example, section 1304(f) refers to "short taxable year" whereas § 443 refers to a "short period". In addition, § 1301, is based on the concept of an "eligible individual" while § 443 is based on the concept of a "taxpayer", a much broader term. Further, § 443 is a mandatory provision, rigid in scope, which defines but two instances in which returns for a "short period" of less than 12 months must be filed. There is no compelling reason why the two situations of § 443(a)(1) and (2), covering short periods of less than 12 months, should be the unique and sole criteria for defining a "short taxable year" for income averaging purposes.*

*With deference to the "principal concern" of Congress "that the individual's income must have been subject to tax by the United States throughout the entire base period as well as the computation year," H. Rept. No. 749, 88th Cong., 1st Sess., 114 (1963), tax avoidance through use of an initial base period year of less than 12 months is hardly a consideration in this or any other case involving a nonresident alien. Clearly Mr. More could not, on April 15, 1965 (the due date of his 1964 tax return) foresee the action of Congress that would create income averaging and thus, as a "new taxpayer" under Reg. § 1.441-1(b)(3), elect a fiscal taxable year beginning on the date he established United States residence thereby qualifying for income averaging in later years. Indeed, the manifest injustice of the result below is highlighted by the fact that, had Mr. More become a resident of the United States at some point after income averaging was enacted, he clearly could have made such an election.

In contrast to the less than expansive definition of "short taxable year" provided in Appellee's regulations at Reg. § 1.443-1(a)(1) and (2), Appellants look to other Code provisions for a definition of a "short taxable year" for purposes of income averaging that produces a more reasonable result.

For example, § 7701(a)(23) defines "taxable year" in pertinent part as follows:

"Taxable year" means, in the case of a return for a fractional part of a year, under the provisions of subtitle A or under regulations prescribed by the Secretary, the period for which such return is made. (Emphasis supplied.)

Not only does this Code provision suggest that the definition of a "short taxable year" for purposes of income averaging means more than the two narrow situations defined in §§ 443(a)(1) and (2), but, when read in conjunction with the regulations for filing tax returns, it provides a more pertinent definition of that term.

Section 6012 provides rules with respect to persons required to make returns of income. The regulations under that section cover nonresident alien individuals who become residents during a taxable year. Specifically, Reg. § 1.6012-1(b)(2)(ii)(a), states in pertinent part that:

If an alien individual becomes a citizen or a resident of the United States during the taxable year and is a citizen or resident of the United States on the last day of such year, he must make a return on Form 1040 for the taxable year. However, a separate schedule is required to be attached to this return to show the income tax computation for the part of the taxable year during which the alien was neither a citizen nor resident of the United States. A Form 1040 NR, clearly marked "Statement" across the top, may be used as such a separate schedule.

When § 7701(a)(23) is read in conjunction with that regulation it becomes clear that the term "taxable year" is meant to refer to "the period for which such return is made." Indeed, the essence of Reg. 1.6012-1(b)(2)(ii)(a), is that while the form of the return is for a full taxable year, "the period for which such return is made" is only that part of the taxable year during which an individual was a resident alien. This contention is augmented by the requirement that a separate statement be appended to the return to cover the balance of the 12-month period. Moreover, a nonresident alien, who was not engaged in a trade or business within the United States, and who did not receive income from sources within the United States, would not be required under § 6012 to file a return which accounted for his income or deductions from the fractional part of

the taxable year covering the period of nonresidency. In substance, this is a recognition by the Appellee of a short taxable year.

Taken together then, § 7701(a)(23) and § 6012 in substance supply an alternative definition of a "short taxable year" which, unlike the provisions of § 443, is drawn from sources compatible with the use of that term for income averaging purposes.

CONCLUSION

It is respectfully submitted that the decision of the Tax Court should be reversed and judgment entered in favor of the Appellant.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
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COMMISSIONER OF INTERNAL REVENUE, : CERTIFICATE OF
Appellee. : SERVICE BY MAIL
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I, ROBERT D. WHORISKEY, attorney for Appellants,
hereby certify that on the 18th day of February 1977,
service of Appellants' brief was made by mailing three
copies to Appellee by post-paid mail, addressed as follows:

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Chief, Appellate Section
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Att: Ms. Sharon Calegari

/s/ Robert D. Whoriskey
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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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JOSE E. MORE AND ADELA T. MORE, :

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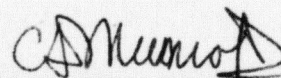
COMMISSIONER OF INTERNAL REVENUE, :

Appellee. :

- - - - - X

I, COLIN D. MUNRO, II, hereby certify that on the
18th day of April 1977, service of the Appellants' printed
Main and Reply Briefs were made by mailing three (3) copies
each to Appellee by post-paid mail, addressed as follows:

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